MEMBERS 1st
FEDERAL CREDIT UNION

Robert L. Marquette
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March 30, 2015

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

RE: Comments on Proposed Rule: PCA - Risk-Based Capital 2

Dear Mr. Poliquin:

Members 1st Federal Credit Union believes the revised risk-based capital proposal is an improvement over the original but still falls short of being a fair and useful tool for NCUA and the credit union industry. While the calculation changes make the rule slightly more palatable, we strongly believe it should not be in addition to the existing capital requirements contained in PCA. If NCUA wants to raise the Well Capitalized level, why don't you go to Congress and ask for an increase to the 7% level rather that add this second calculation which will be expensive and add an additional reporting burden on the industry and to the NCUA. NCUA has not provided justification for why it feels it is necessary or how this new regulation will help "save" the NCUSIF in a crisis. The new regulation only effects 1,150 CU's - are you sure that is where most of the potential problems lie? If you wanted to use it as a measure for the "complexity" of a credit union for an exam, it might make sense; but to force the change requirement and added cost on the entire industry doesn't.

Risk-based capital regulations didn't help the banking industry in 2008. For NCUA to adopt a similar requirement and think it will save the NCUSIF in a similar situation is just being myopic. Why would we want to use a system based on the commercial banking industry anyway? We are CU's and our balance sheets and practices certainly aren't lockstep with those of the commercial banking industry?
Only 112 credit unions failed during the 2008 Recession costing the insurance fund less than $1 billion, which is remarkable considering the dollars and number of commercial banks that failed and they had a comprehensive RBC plan in place; it lulled them into a false sense of security. Why does the NCUA insist on wasting CU dollars and their own, by adding net worth dollars, complexity, and information gathering and reporting for the 5300 on an unnecessary new ratio? Of the CU's that did fail during the crisis (except for the 3 corporate CU's that NCUA force-closed) most were under the $100 million asset size threshold that NCUA is using. From 1998 – 9/30/2012, the NCUSIF fund losses were only $968 mil.; $513 mil came from 7 CU's in the $200 – 500 mil asset range; $343 mil came from CU's under $100 mil that won't even be covered by this regulation (see attached).

The 2008 crisis (as are most) was a credit issue problem (the "home ownership is good for everyone" bubble) that resulted from everyone (Congress, the Regulators, and some Financial Institutions) drinking the American Dream kool-aid of owning a home, even if they couldn't afford it. Prudent examination of

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a CU's credit policies and procedures would be a much more effective way to keep issues under control at a CU This capital ratio play is just a band-aid and "solve all" that won't provide the safety net that NCUA thinks it needs. The fact that fewer than two dozen CU's will even be categorized as less than "Well Capitalized" under this proposal indicates that. In fact, many CU closures result from fraud by associates at smaller institutions. This regulation won't cover that problem and will cost NCUA untold expense on information gathering and processing from the 5300 changes needed to meet the reporting guidelines.

We are also very concerned about the very subjective capital adequacy provision included in the proposal. This new rule requires a qualified credit union to "maintain a written strategy for assessing capital adequacy and maintaining an appropriate level of capital". These capital adequacy plans would have to be approved by NCUA and could be used by examiners as a pretext to require individual credit unions to hold capital above the levels required by the proposal. I have heard NCUA Board member's state that NCUA already has the authority to force an individual credit union to increase their capital. Therefore, it appears this provision in the proposed rule is unnecessary and redundant to authority NCUA already possesses. We oppose the requirement for a policy and plan demonstrating capital adequacy. Credit unions provide for capital adequacy through budgeting, ALM planning, liquidity, interest rate risk and risk management. We view this as a discretionary regulatory requirement that will be judged in an arbitrary, subjective manner by the hundreds of NCUA Examiners as a result of the examination process. This provides too much authority to change the "playing field", especially when there is no independent entity to which a CU can appeal an NCUA decision. The current appeal process, if taken that far by a CU, allows that an independent arbitrator's decision isn't binding and the NCUA Board may choose to ignore it.

Finally, we'd still like to ask the question; does NCUA have the authority in the Federal Credit Union Act to impose this second capital requirement rule? We don't think so, and still don't after reading the "independent" legal opinion that said "well, we think maybe they do, but...".

We would also like to address several provisions that we believe to be unusually stringent given the structure of credit union balance sheets:

Risk Weights: We appreciate that they have been reduced. However, this scheme remains overly complex. The treatment of first mortgages and junior liens is out of proportion to their risk profile. The rule should arrive at a risk weight for these assets by including a study of loss history and the market where a credit union operates. This same process should apply to the risk weighting of MBLs as well. Pennsylvania has not experienced volatile adjustments in the value of real estate.

Using the first and second lien position as a means of categorizing the risk based capital % for mortgage and home equity portfolios seems to be out of place. The loan to value ("LTV") of the collateral would be a better way to judge the capital risk of a loan than the lien position. Were individual product loss ratios used in determining the risk weightings? We doubt that was the case since our loss ratios for both 1st and second lien mortgages is among the smallest of our product line.

Member business loans ("MBL"), the vast majority of CU MBL's have real estate as collateral, but the calculation treats them as 100% assets, the same as the commercial banks. However many bank commercial loans are not collateralized by real estate - they use receivables, etc. which are much more risky. We believe the risk weighting should be reduced from 100% to 75% - higher than the very fluid residential real estate market at 50% but less than loans with no physical collateral at all.

We disagree with excluding the NCUSIF deposit from both sides of the calculation. While NCUA won't give the deposit balance to a struggling CU to help it resolve any deficient capital issues, it is still the members' capital. Some consideration, even at a reduced risk weighted level, should be granted for this asset on both sides of the calculation.

We are also concerned about the 250% rate for mortgage servicing rights which are no more risky than the assets they are tied to and the only variance is the length of time needed to amortize the asset - we don't believe that warrants a 250% level.

The loan categories continue to have, albeit reduced, concentration risk elements included. These are unnecessary and should be eliminated.

There is still no supplemental capital provision. By limiting the ability of CU's to increase capital only through earnings, this regulation could force some to "improve" their ratio position by selling off valuable assets, hurting them and the industry in the long run. All too often I have heard NCUA staff encourage credit unions to "shrink their balance sheets" simply to meet a net worth ratio – rather than come up with a long term plan to increase net worth and continue to provide credit union service to as many Americans as possible.

We appreciate and agree with NCUA removing all interest rate risk factors from the RBC2 calculation; we also believe that the current IRR policy and program standards adopted in 2012 are more than sufficient to allow each CU and NCUA to monitor a CU's position for rising or falling rates and therefore do not believe any additional requirements are appropriate or necessary.

We believe there is no merit to adding a risk based capital level calculation requirement. The current PCA system has served the industry well and was more than sufficient during the 2008 recession. The cost of the additional capital, the reporting burden and costs associated with it to credit unions and the NCUA would severely undermine the industry's ability to grow, compete and provide the products and services their members both need and desire. When you consider that the total losses to the NCUSIF over the last 7 years since the economic collapse in 2008 were comparatively small at less than $1 billion, it appears that this regulation is overblown and unwarranted. Again, while only about 19 credit unions would initially see their capitalization category reduced with this proposed regulation, many credit unions would struggle to meet the RBNW requirement for well capitalized as they grow in the future. In addition, any significant economic disruptions would only exacerbate a credit unions ability to adjust to such situations, while trying desperately to also continue to meet these arbitrary, unnecessary additional net worth requirements. This would reduce credit union growth, and make us less competitive to other financial institutions.

Sincerely,

Robert L. Marquette
President and CEO
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Mechanicsburg, PA 17055

(attachment)

	Number of Failures		NCUSIF Loss ($M)		Percentage of Total NCUSIF Losses	
Assets ($M)	Failures for Asset Range	Cumulative	Loss for Asset Range	Cumulative	Percent for Asset Range	Cumulative
< $10	205	205	$138.5	$138.5	14.3%	14.3%
$10 to < $20	12	217	$31.0	$169.5	3.2%	17.5%
$20 to < $30	8	225	$22.8	$192.2	2.4%	19.9%
$30 to < $40	9	234	$36.2	$228.4	3.7%	23.6%
$40 to < $50	4	238	$11.3	$239.7	1.2%	24.8%
$50 to < $60	1	239	$3.3	$243.1	0.3%	25.1%
$60 to < $70	0	239	$0.0	$243.1	0.0%	25.1%
$70 to < $80	2	241	$11.3	$254.4	1.2%	26.3%
$80 to < $90	4	245	$22.4	$276.8	2.3%	28.6%
$90 to < $100	3	248	$66.1	$342.9	6.8%	35.4%
$100 to < $200	10	258	$76.3	$419.2	7.9%	43.3%
$200 to < $500	7	265	$512.7	$931.9	53.0%	96.3%
≥ $500	1	266	$36.1	$968.0	3.7%	100.0%

As reflected in the table below, almost half of total losses over the last ten years for FICUs under $50 million in assets occurred in credit unions with under $10 million in assets, which were already exempt from interest rate risk and risk-based net worth regulatory requirements.

Asset Size	< $10M	< $20M	< $30M	< $40M	< $50M
# Failures Last 10 years	132	143	151	160	162
Losses ($M) Last 10 years	$104.4	$150.3	$171.7	$207.9	$212.8
Avg. # Failures Per Year	12.3	13.3	14	14.9	15.1

More specifically, NCUA determined that, as of the last Call Report, only one credit union between the proposed $30 million threshold and a $50 million threshold would have been subject to additional PCA because it failed to meet risk-based net worth requirements. Further, only 4.5 percent of FICUs with assets between $10 million and $50 million have a net worth ratio below seven percent.

For the interest rate risk rule, 56.3 percent of the approximately 2,270 FICUs between $10 million and $50 million were not covered by the rule as of the last Call Report, because their level of first mortgage loans and investment maturities, relative to net worth, exempted them. The 992 FICUs with assets between $10 million and $50 million that were subject to the interest rate risk rule as of September 30, 2012 (because of their level of first mortgage loans and investment maturities, relative to net worth) held only 2.7 percent of industry assets. As with IRPS 13-1, the Board will review and consider adjusting the thresholds in 12 CFR 702.103(a) and 741.3(b)(5) within two years of the effective date of this final rule and, subsequently, at least once every three years. This review period will permit the Board to adjust the thresholds accordingly if the risk and losses attributable to increased thresholds are greater than expected.